RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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Dec. 21, DJIA 838.91; PTI 1139; A-D ratio –18.32
Dec. 28, DJIA 838.91; PTI 1143; A-D ratio –18.34

THOUGHTS FOR THE 1980's: If you buy votes one by one in the US it's a felony. If you buy millions of votes at one time, it's Congressional or Presidential campaign strategy.

A taxpayer is someone who works for the government without having to take a Civil Service Exam (thanks to Stock Market Almanac).

With Russia taking over Afghanistan, with Iran taking over the US Embassy, with OPEC taking over the US's energy future, with deficits taking over the US economy, I want to thank our red-hot pro football team, the San Diego Chargers. Not only do they give me a rare glimpse of US power, they have taken my mind off the markets and the world for at least three hours every weekend.

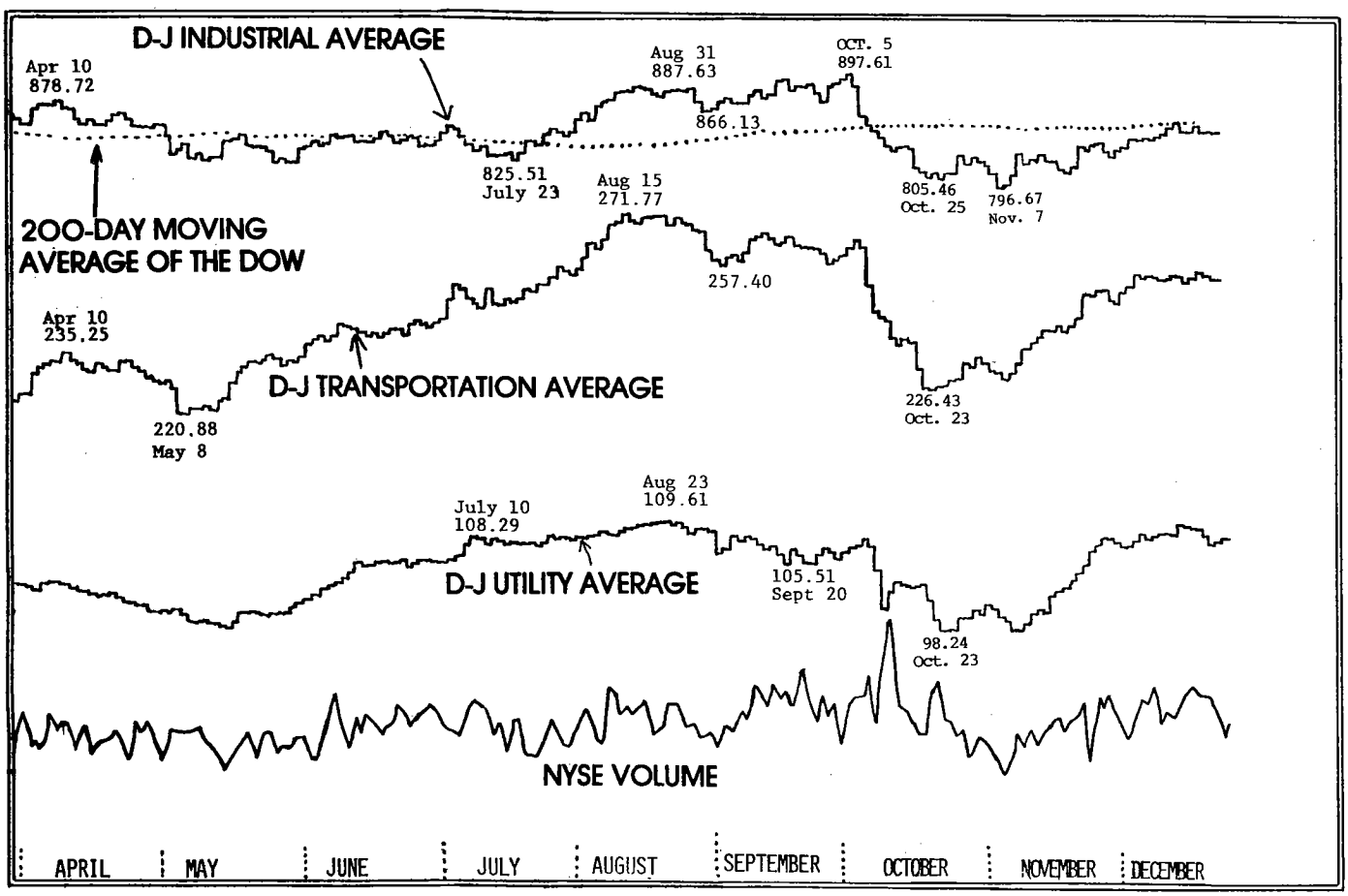
THE MARKET: I'll stick by the opinions expressed in the last Letter. The market looks tired. The year-end rally, so far, has been unimpressive. The Dow has still not recovered even half of the losses sustained during the October panic (halfway would be 845). The Transports look tired. The Utility Average looks toppy. The 20-Bond Average has sustained one of the worst two-month losses in its 65 year history.

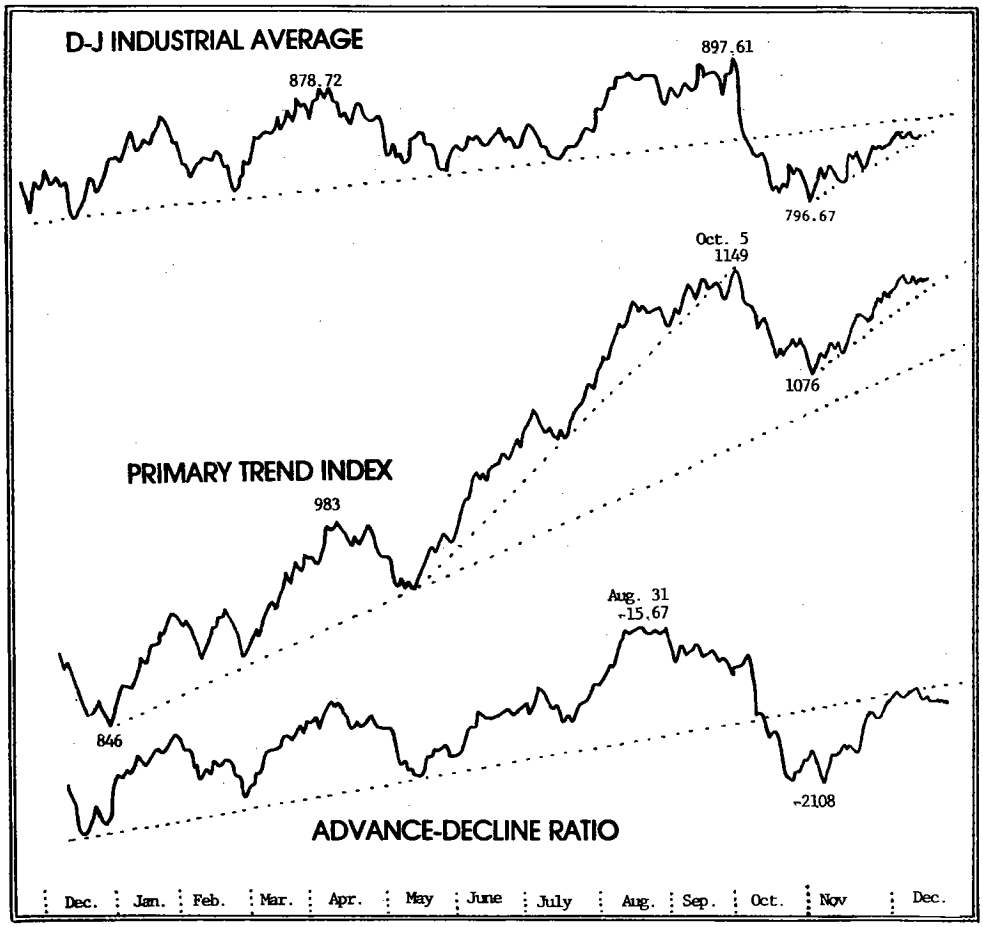
In the last Letter I showed charts of the zero-ending years. Ned Davis of J. C. Bradford now notes that in each of the *election* years ending in zero (1960, 1940, 1920, 1900) the *yearly* high was made on the first or second trading day of the new year. Furthermore, the average decline from the peak to the low during those four zero-ending election years was 26.5%. Let's see if history repeats. Nothing would surprise me here.

The debate rages regarding the worth of the Dow as an indicator. In a singular divergence, the Dow during 1979 was up only 4% while the AMEX index was up 60% for the year. Yet even this is deceptive since a limited number of AMEX issues did the work, The advance-decline line for the Amex hit its high in April and its low in October. As of now, the Amex A-D shows a net gain of zero for the year 1979.

On December 12 the 13-week moving average of the Dow broke below its 50-week moving average. Veteran subscribers know that this action constitutes a "sell signal" for the Dow under the moving average study. The 50-week MA for the Dow is now 847 while the 13-week MA is at 832. The divergences in this market continue to be extraordinary, but how long this can continue is a question that bothers me no end.

With it all (see page 2 chart), my Primary Trend Index has been creeping up to within a few points of its October 5 high of 1149. A rising PTI (or even new highs on the PTI) does not guarantee

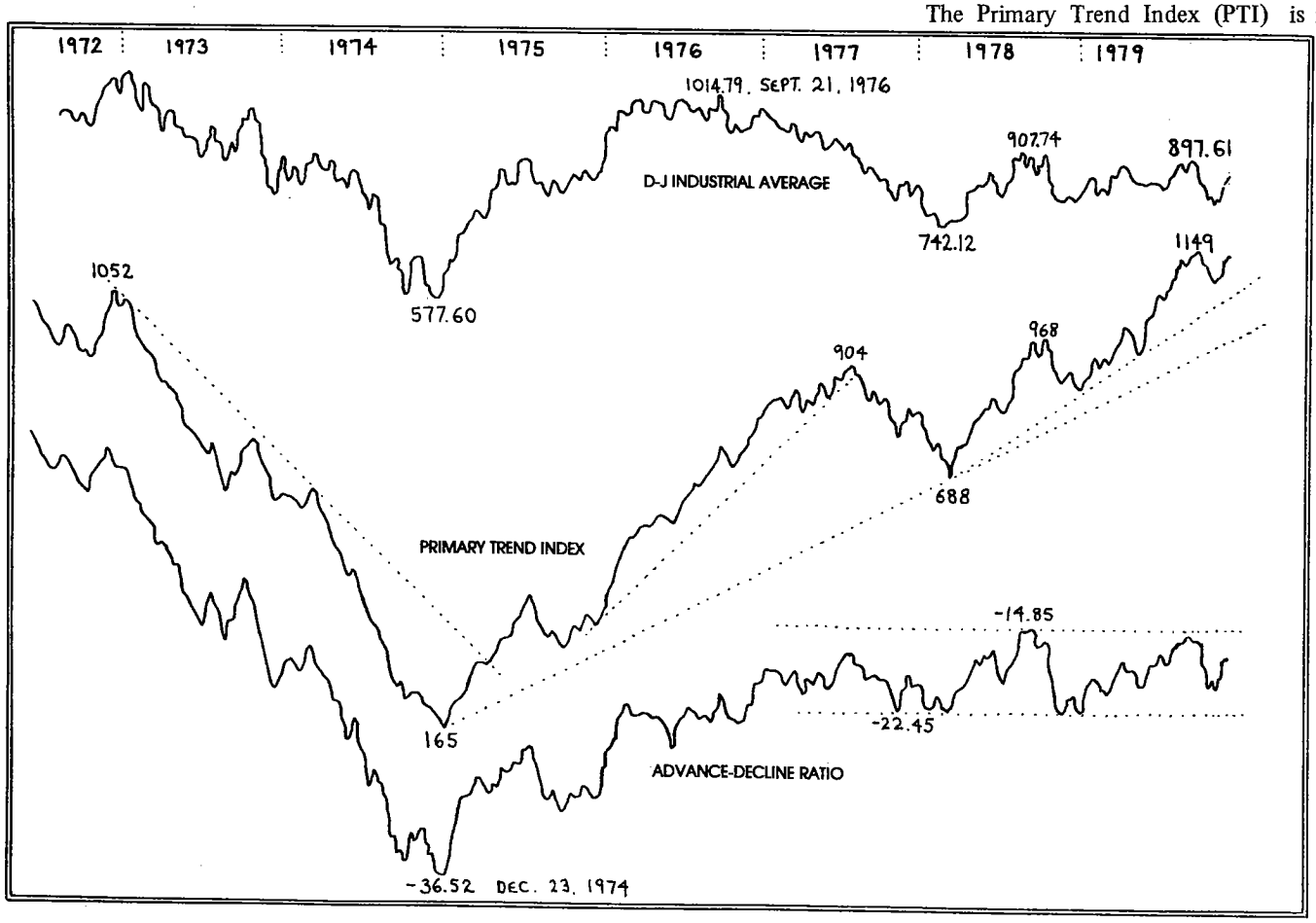




new highs in the market averages. But no market is going to fall apart as long as the PTI is in a rising trend. Reading between the lines, I must admit that it bothers me that the PTI continues to climb, while despite this the Dow and the A-D ratio are lagging. But the PTI tells the story, not yours truly, and so far the story is an upward trend in the PTI.

LONG-TERM PERSPECTIVE: I am including in this first Letter of 1980 a *long-term* chart of the Dow, my Primary Trend Index and the advance-decline ratio. The salient feature of the Dow is that it recorded a peak of 1014.79 on September 21, 1976 and has established LOWER peaks during each year since. Against this, the D-J Transportation Average (not shown) has recorded a successive series of new highs since 1976. The series of lower peaks on the Industrial Average set against the rising peaks in the Transportation Average has produced the most flagrant long-term divergence in the history of the Averages going back to the turn of the century. I would be less than honest if I said that this divergence doesn't worry me. It does. I don't know what it means. It has been going on so long (over three years) that nobody seems to notice it any more. But it is there, and according to classic Dow Theory it constitutes a long-term danger signal.

The Primary Trend Index (PTI) is my



own invention. It is an amalgam of 8 critical averages and indicators including the D-J Stock Averages, the D-J Bond Average, the S&P 500, the daily high-lows, the daily most actives and the A-D ratio. The method of construction of the PTI is my own secret. It is the only secret I keep in this work, and I keep it because if everybody knew how to construct the PTI, this indicator (like so many others) would shortly lose its effectiveness.

I have run a number of rising trendlines on the PTI. The most important is the trendline connecting the 1974 and the 1978 low. This is the major rising trendline, and the PTI is holding far above this trendline. A shallower trendline connects the 1978 low and lows recorded in late-1978 and mid-1979. We are currently well above this secondary trendline.

On December 17 the PTI hit a high of 1147, just 2 points below the 1979 high recorded on October 5. The PTI then turned down. On the larger picture, it is extraordinary that the PTI has continued to climb against an overall sluggish (sideways) performance on the part of the Dow and the A-D Ratio. It is encouraging that despite the relative weakness in the Dow and the very broad A-D measurement, the PTI continues to climb. I believe that throughout this period the PTI was "saying" that the technical foundation of the market was strong. Despite all kinds of shocking news, despite a steady rise in interest rates (and 2 of the 8 PTI components are directly tied to money rates) the PTI kept climbing. It was an extraordinary performance.

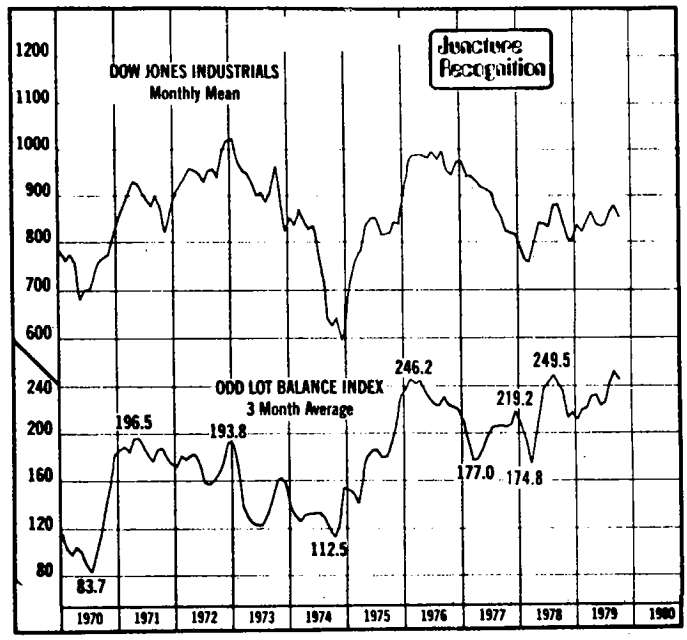
But one thing bothers me. Any trend will last *just so long*. Or to put it another way, the longer a trend lasts, the less reliable it is. And I say to myself, "The bull trend on the PTI has now lasted 5 years. This is a very long time for ANY market trend to remain in force. How much longer can the PTI continue to advance? And if the Dow and the A-D ratio are this sluggish in the face of a rising PTI, what happens when the PTI ultimately turns down?"

Of course, I have no right to try to outguess the indicators, to try to jump the gun on my own barometer. When the PTI finally does turn bearish and starts violating its trendlines, then will be the time to turn bearish. Until that time, the PTI, to my mind, provides a fascinating study. The longer I deal with the PTI, the more I respect it.

At the bottom of the chart we have the A-D ratio. The A-D ratio is a proxy for the entire NYSE. As you can see on the chart, the A-D has been moving essentially sideways since late-1976. It has been in a range of 6 points for over 3 years. The ultimate breakout of this range should have far-reaching implications. But while the A-D remains in this range, patience, great patience will be needed.

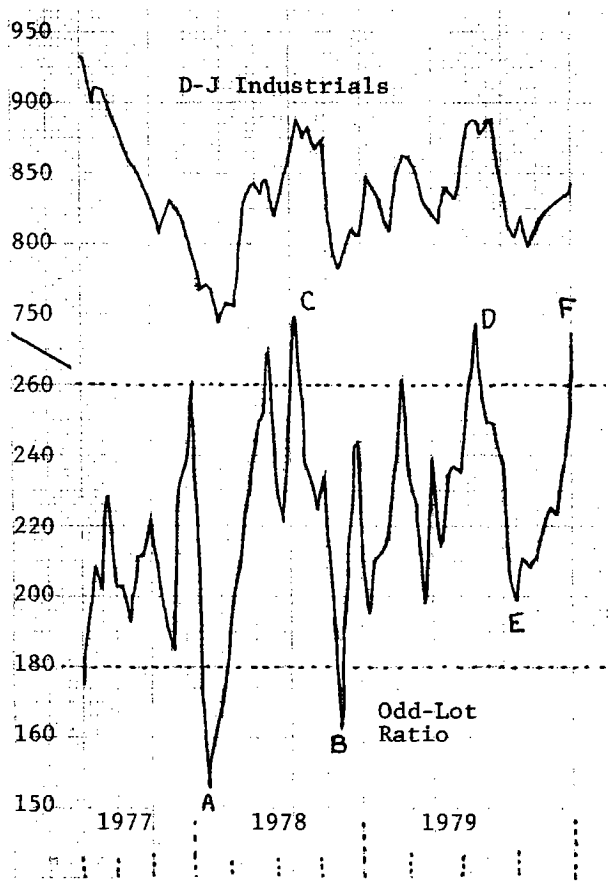
ODD LOTS: I've been following the odd lots ever since I started in this business back in the 1950's. This is a study that was very popular during the 1950's and '60's, but during the 1970's the odd lot study lost its following (probably due to over-popularity in earlier periods). Strangely, however, I find that the odd lot statistics still provide valuable clues as to the trend of the market.

First let's start with the long term picture. The basic tool of the odd lot studies is the "balance ratio." This is simply the daily odd lot sales divided by purchases. For instance, a figure of 110 means that for every 100 shares purchased, 110 shares were sold. A figure of 160 means that for every 100 shares of odd lots purchased, 160 were sold.



For the purpose of long term study, Bill Bretz has put these ratios on a 3-month average, and this condenses the action tremendously. Here we see the peak of actual buying (ratio 83.7) in 1970. From there the odd lotters swung to selling as the ratio rose to 196.5 in 1971. The ratio moved towards buying (actually less selling) from 1971 to 1974. In 1974 the ratio hit 112.5.

Note that ever since 1974 the ratio has been moving further and further into the selling area, rising to 249.5 in 1978. Why are the odd lotters selling today? Probably because they can do better in the money market. Or at least they "feel" they can do better. The statistics show where the money is going. At the start of 1979 the so-called "money market funds" held $10.7 billion in assets. The latest figures show that the assets of money market funds have risen to $43 billion. On the face of it, the odd



lot public is moving out of the stock market and into money market funds.

Will the public be right? We don't know, but we do know this. At major bear market bottoms the odd lotters are on the buying side of the market. They seem to sense that great values are in the offing, and this phenomenon can be seen on the chart at the 1970 and 1974 bottoms. (Long-term chart courtesy of Juncture Recognition, Box 1209, Pompano Beach, Fl . 33061).

The relative level of odd lot trading perimeters changes over the years. For instance, odd lot ratios fluctuated between 60 to 100 during the 1950's. But now with selling predominating, the odd lot perimeters are roughly 160 to 260. This can be seen on my own weekly chart of odd lot ratios.

Over the past few years, whenever the odd lot ratios dropped down to the 150-160 area it was safe to conclude that the market was in a bottoming area. These areas are marked A and B on the chart. Conversely, whenever the odd lot ratios climbed to 260 or above (i.e., the upper limits of selling), it was safe to conclude that the market was in a topping area.

Point E on the chart was reached on October 24. At that point the odd-lot ratio touched a low of 199 with the Dow at 816.64. From there the Dow and the market pushed higher. By late-December (point F) with the odd lot ratio at a very high 275 and the Dow at 840, the caution signals (under this study) were flying.

One reason why the rally (so far) has not been more impressive is that the odd lot ratio (at point E) did not drop below the 180 level as it did in early 1978 at point A or in late 1978 at point B. Thus, the market was not "sold out" as it was at points A and B.

THE TRANSPORT "THREES": I have mentioned the historic divergence in the Averages many times, and, of course, I am talking about the divergence between the Industrials and the Transports that began in 1976. In this Letter I want to discuss a phenomenon that I have never mentioned before. This is the series of three rising peaks in the Transportation Average.

One of the great pioneer market analysts (I believe it was Gartley during the 1930's) once wrote that a series of three rising tops held bearish connotations, while a series of three successively lower bottoms held bullish connotations. Somehow, that rather surprising observation has always stuck in my mind, and over the years I have watched for this series.

The place where it has been most useful to me is in the study of the Transportation Average and I am grateful for market analyst Harry Laubsher (Paine Webber Mitchell Hutchins) for bringing the current structure to my attention. I am including this Horsey chart of the D-J Industiral and Transportation Averages going back to 1950. The divergences and triple Transport peaks of the past were so flagrant that they show up clearly, even on the *monthly* high-low chart.

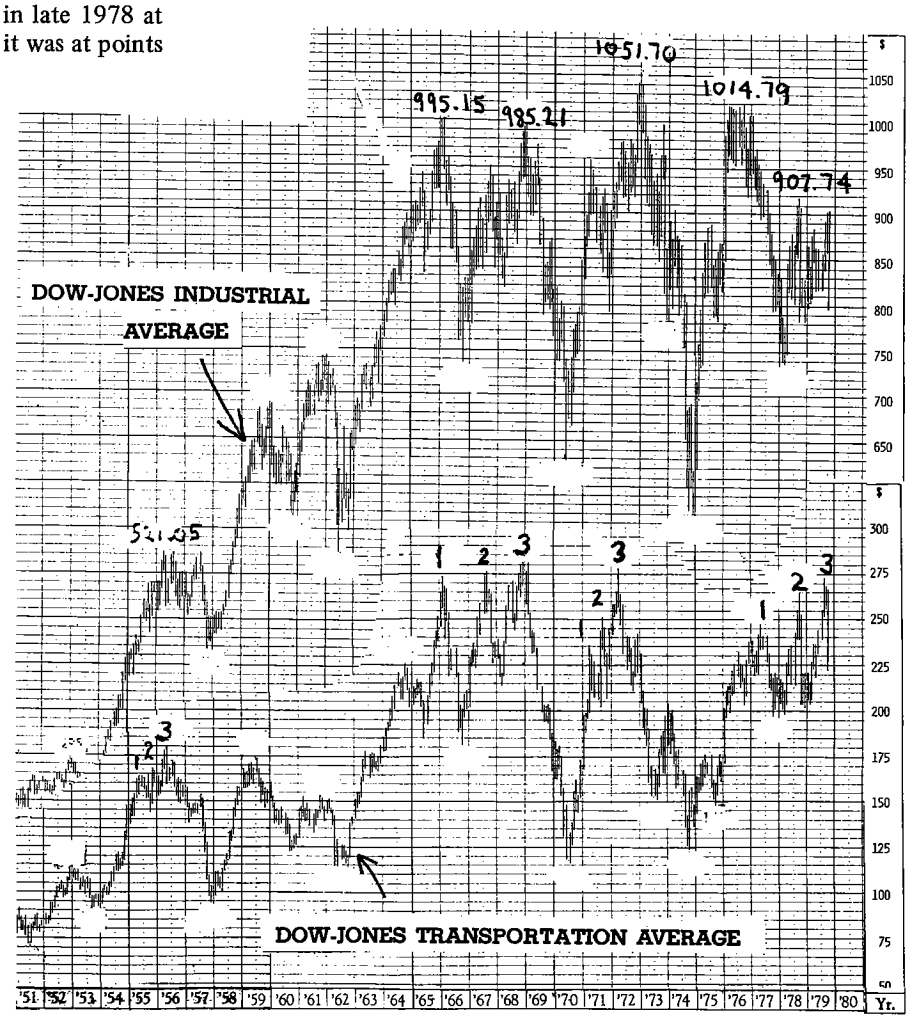
The first series of three successive Transport peaks appears during 1955-56. Transports hit 164.29 in September, 167.83 in November and 181.23 in April, 1956. Industrials touched 521.05 in March, topped in July, and then the market started sliding, ending at 419.79 in October, 1957.

The second series of "threes" in the Transports started in 1965 and extended to 1968. During that period Industrials hit a peak of 995.15 (1966), a lower peak of 985.21 (1968) and then the cave-in occurred.

During 1971 and 1972 "triple threes" in the Transportation Average again appeared. although the Industrials did not diverge. Instead, they recorded an all-time high in 1973 of 1051.70, but the record high was followed by the worst bear market since the 1930's.

During 1977-79 another well-defined triple threes appeared in the Transportation Average. In 1977 the Transports hit a high of 246.64. In 1978 the Transport peak was 261.49. On August 15, 1979 the Transports recorded a high of 271.77, then fell back along with Industrials.

So the question I am asking myself is this: "Are we again watching the drama of the "three successive peaks" in the Transportation Average?" Certainly, the pattern in the Transportation Average is clear enough, obvious enough. If the "threes" syndrome is to hold true to form, we should expect general trouble in the market during 1980 (it is now 4 months since the last Transport high of August 15).



During 1978 and 1979, as the three peak pattern was forming, we have seen ragged markets with two panic declines (late-1978 and late-1979). On a cold reading of the Averages based on past case histories, my feeling is that the latest group of threes in the Transports is a caution flag for all investors.

NOTES & QUOTES: I'm a believer in numbers. The "big numbers" often have big significance, but that significance is not always obvious. It remains for us to understand the meaning of the numbers.

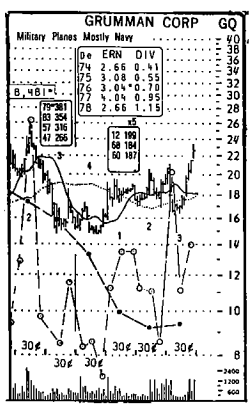
Markets, trends, events, often start, stop, explode, accelerate at the big important number-levels such as 50, 100, 200, 250, 500, 1000, etc. Nobody can explain it (except perhaps psychologically) but it happens often enough to be beyond coincidence.

The US was exactly 200 years old in 1976. We celebrated our 200th anniversary all across the nation. The Dow hit 1014.79 on our 200th anniversary year, and that was the last time the Dow went over 1000. Earnings on the Dow are higher now, dividends are higher, book values are higher. But the Dow isn't higher. Someday, someday maybe the Dow will go over 1000 again–and head up from there. I know I'll feel better (more confident) if and when that happens.

Gold is over the big 500 level now. It happened just as the decade of the 1970's was ending. Maybe 500 dollar gold is telling us something about the '70's, and maybe its providing us with a warning for the '80's. I looked at a Krugerrand the other day, and I thought to myself, "You've come a long way, baby." My old friend, James Dines predicts that we'll see the day when gold and the Dow cross over in price. I heard Jim say that many years ago when there was over a 900 point spread between the Dow and gold, and James sounded like a damn fool then. Now, with a 325 point spread Dines doesn't seem so crazy. In fact, he seems almost clairvoyant.

Meanwhile, the US national debt is now at $835 billion dollars and heading towards the astronomical but even figure of a cool one trillion dollars. Which remainds me of that ancient warning, "Whom the gods would destroy, they first make mad."

STOCKS: I've been recommending them for some time–defense stocks. This is one group that should be relatively insulated against trouble in the stock market. Last week many of the stocks recommended here, Rockwell, Martin, Grumman, Litton, hit new highs. There's little question in my mind that the US will now be forced to step up its military capabilities. The impunity with which Russia now expands its power base has now emerged for all to see. The US reaction to each new Soviet move is, "Hey, we strenuously object to this!"



But the US military knows what is happening, and they are pressing for greater arms commitments. All this will show in the trend of defense oriented stocks in the period ahead.

Grumman looks strong here and is a big supplier of navy planes. What most people don't know about Grumman is that it is the largest manufacturer of solar heating devices in the nation (and, as a matter of fact, I'm installing a Grumman solar water heater in our house this week). As a matter of interest, all new homes in San Diego County, by law, must have solar heating devices. Solar heating, to my mind, is one of the waves of the future. Chart of Grumman courtesy of Quote Digest, PO Box 212, Wichita, Ka 67201).

MORE NOTES: The OPEC nations (with a few exceptions) are now moving past the point of merely raising oil prices to make up for declining dollars. They have reached the point where naked greed (and hatred of America and Europe) is taking over. I've studied men's emotions and market emotions for many years. In my opinion, the single most destructive emotion in a man's life is resentment (a smouldering form of hatred). Resentment is an emotion that is *never completed.* It's like the bulldog who never bites through and never releases his death grip. For this reason, resentment is very destructive; it has ruined many lives.

The counterpart of resentment in the market or the economy is GREED. The greedy man or nation *never has enough*, they are never through. I believe that OPEC has reached that destructive stage now. Of course, behind this greed lies decades of resentment towards the West, decades of hatred towards the wealthy nations who looked down on the Mideast and its "filthy hoards" of Arab beggars and fly-infested rabble. All this is built into what we see in the almost weekly rise in the price of oil.

Greed (for whatever reason) must end in turbulence and pain–and very likely disaster. The rise in gold and silver is a function of many things, the first being US immorality (deficits and inflation) and the second being (Arab) greed. But intuitively, I know this–we're now at the stage where the surprises are due to appear. When the surprises arrive, people are going to get hurt, badly hurt.

* *

A dramatic economic story is emerging. It's title is, "What's happening to the Saudi Arabian reserves?" According to the New York Times (Dec. 12) the decline in Saudi reserves is puzzling the West. Since the end of 1977, Saudi reserves (mostly in dollars) have dropped from $32 billion to $17 billion, a loss of $15 billion! One expert describes this as "the tip of the iceberg," noting that in the past the Saudis have disguised the true size of their gold and dollar holdings.

What we may be seeing, then, is a massive flight of capital out of Saudi Arabia and out of dollars. The dollars are going into gold, into real estate, into businesses. The implications are clear enough. Whatever the powers that be in Saudi Arabia see, they don't like.

* *

Barron's Editor Bob Bleiberg was interviewed in the excellent monthly report of the American Economic Council (9301 Wilshire Blvd., Beverly Hills, CA 90210). Bob is not a man to mince words, and I thought this part of the interview was particularly interesting. Bob was asked what he would do if . . .

> ***Q: You're now in charge of the whole operation, you now have the power to do whatever it takes to resolve our economic problems.***
> *A:* You're going to make me a benevolent despot.
> ***Q: Absolutely! What do we do?***
> *A:* What do we do? We cut the Federal budget right in half, dismantle half or two thirds of the Federal government, just for openers. I've got to really retract that, talking seriously about it, you'd have to do it over a five year period. You would announce that we will phase out HEW over the next five years, phase out ERDA over the next five years, and phase out the Veterans Administration over 10 years if you like; we will phase out a great many governmental activities. Phase-out would be the operative words; you can't do it overnight. You really can't. People have made dispositions based on existing verities, certain things that exist at the moment. You can't do it to them overnight, but you can let them start making new long-

> range plans to go to work. So, that is what I would really do. I would announce a phased reduction of the Federal government by at least 50% and that would be, as I say, just for openers. By the time I was through, the Federal government would have nothing left but the armed forces, the Federal district courts, the circuit courts. Of course, I'd cut taxes, concurrently on a phase-out basis and then I would stand back and watch us enjoy another 50 years of the prosperity we enjoyed between 1860 and 1910.

* *

Speaking of cutting, California may be leading the way. Following hard on the heels of Proposition 13, Howard Jarvis (the terror of the bureaucrats) has now put what is termed "Jaws 2" (Jarvis 2) on the ballot to be voted on in June 1980. Jaws 2, if passed, will cut California state revenue more than 50%! So frightened are California bureaucrats of this bill that they will not come out against it in public for fear that a word against it would ruin their next election chances. The odds for Jarvis 2 passing: very good to excellent.

* *

BONDS: Interest rates on short term instruments may have peaked, but the bond market is still shaky. My advance-decline line of NYSE bonds has touched a new low, as have my gauges for municipal bonds. The Treasury bonds have come down to test their recent lows, but so far those lows are holding. The bond market is obviously trying to measure the size of new money requirements for 1980 plus the trend of inflation in 1980. So far, I would have to say that it is not happy about what it sees.

The losses in bonds during 1979 have been of absolutely staggering proportions. Year-end tax selling has depressed the bond market even further. I feel that high-yielding bonds at this point only make sense for pension funds (no taxes), or funds in which high-yielders can amortize the cost of the bonds away–and quickly. For the average investor it would be best to stay in the short-term. Those who want to "speculate" can go out to maturities of 2-4 years.

GOLD: Gold may be cool to the touch, but it was boiling during December. I want to dedicate this section to two gentlemen who saw all this coming many years ago. One of them was Jay Pfister, a Swiss investor and one of my first subscribers during the 1950's. I can see Jay now in his natty black suit, sitting with me at the Plaza bar and shaking his head. "You know, Richard, someday you're going to see gold go through the roof as it reflects all the ills and mistakes of deficit spending. I know it will happen, and I don't know if I want to live to see it or not." A big gold holder, Jay died about 7 years ago. He never saw the "gold spectacle." Maybe it's just as well.

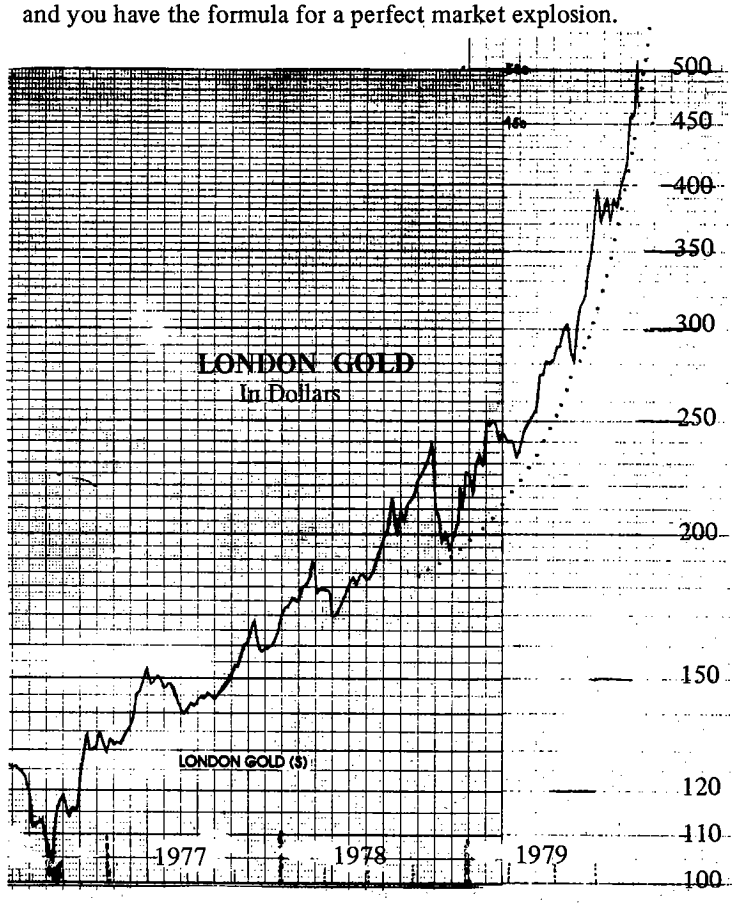
E. George Schaefer was a great market analyst, a great Dow Theorist, and a fervid believer in gold. George often told me, "Richard, at some point in time gold is going to take off and go and go and go. Remember (and this was his favorite expression regarding gold), there's no fever like gold fever." And now we see the truth of George Schaefer's words. George died in 1974 but I think of him often as the radio blares out the latest gold price. George was absolutely right about gold, as right on the metal as he was on the great bull market of 1949-66. Schaefer firmly believed that after the boom we would see a major depression in the US and the rest of the world. Once I asked him where he thought the Dow would be at the depths of the depression. "In the 300 area" was his reply.

So here's to Jay Pfister and E. George Schaefer. Jay was instrumental in getting me to move to California (he lived in Laguna Beach) and George was a tremendous help to me in getting me into this business. Both clearly foresaw the coming explosion in gold; neither lived to see it.

What does the move in gold (and silver) mean? I think that it's partly a flight from paper, partly a reflection of big money diversification, and increasingly it represents mass speculation in the hottest game in town. Frankly, I don't take pleasure in any of the three reasons for the gold explosion. All are based on fear or greed.

The massive rise in gold is not occurring within a vacuum. I've commented before about the amazing advance in prices in stamps, coins and other "collectibles." The world of art is now going absolutely mad (in my opinion) with prints bringing in hundreds to even thousands of dollars a piece and many paintings that were almost unmarketable ten years ago now fetching unheard of prices. Time Magazine (Dec. 31) has a feature article on this mania; the piece is well worth reading. Of course, behind all the speculation lies the deficit-producing, paper-printing policies of the US Government. Year after year the deficits are deliberately budgeted, then surpassed. Year after year the dollar declines in purchasing power. Year after year the public's fear grows.

How far will this gold move go? Back in Letter 764 I showed that gold was climbing on an exponential basis (chart updated here), and that the climb was approaching the vertical. This is the "blow-off" phase of the advance, and I feel that gold (and silver) are now being fired by emotions, the desire to beat inflation, and the urge to "double or triple my money." Add to that Schaefer's observation that "there's no fever like gold fever" and you have the formula for a perfect market explosion.



One thing is clear. The short sellers of gold and silver (commodity markets) are being crucified. At some point, they will be utterly destroyed, and then the technical position of the metals will become tenuous. From that extended position, we could see a fall in the metals that will be as violent as the advance. But when and from where the top will come, that's a question that only a fool can answer with confidence.

NEXT MAILING: January 16